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SEP 15 2003
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No. 03-~~324~~ 244

IN THE

Supreme Court of the United States

DAIWA SECURITIES AMERICA INC.,

Petitioner,

—v.—

FRED KAYNE, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF RESPONDENTS BDO DUNWOODY, LLP, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Statement of Questions Presented

1. Does the Private Securities Litigation and Reform Act (the "PSLRA") apply to claims asserted in an action filed prior to its effective date, December 22, 1995?

2. Did the Second Circuit Court of Appeals err in entering a bar order precluding the Non-Settling Defendants, including Diawa Securities America Inc. ("Diawa"), from pursuing claims against BDO Dunwoody, LLP ("BDO"), the Settling Defendant, where the damages claimed are, like contribution claims, based on Non-Settling Defendants' liability to the Plaintiffs?

Statement Pursuant To Rule 29.6

Pursuant to Rule 29.6, Respondent BDO makes the following disclosure:

There are no publicly held companies that own 10% or more of the stock of any Respondent.

BDO has no parent company.

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Reasons for Denying the Writ[1]

In this case, the bar order entered by the Second Circuit bars claims for indemnification, contribution, or other claims where the Non-Settling Defendants seek damages based on their liability to the Plaintiffs. As demonstrated below, courts have long recognized that settling defendants can and should be relieved from the threat that non-settling defendants may seek to shift their liability to Settling Defendants by pursuing supposedly "independent claims," where the damages are the same as those resulting from the injury to the plaintiffs. Such claims are properly extinguished by entry of a bar order.

It is a central and undeniable tenet of the legal system that public policy favors settlement. It is also true that settlements must be fair. As the common law of bar orders has evolved, courts have consistently approved the entry of bar orders where they are accompanied by appropriate judgment reduction provisions to protect non-settling parties. Here, the judgment reduction clause puts all of the risk on the Plaintiffs, because it gives the Non-Settling defendants a judgment credit for the *greater* of the Settling Defendant's proportionate fault or the payment attributable to the settlement. Thus, the Non-Settling Defendants will *never* pay more than their proportionate share. Accordingly, the settlement cannot be unfair to the Non-Settling Defendants and the twin policy goals of settlement and fairness are achieved.

On the other hand, allowing the Non-Settling Defendants to pursue claims against the Settling Defendants, where their injury is measured by the amount that they owe to plaintiffs in the underlying litigation and where

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[1] BDO joins in the Brief of Respondents Fred Kayne, et al. In Opposition to Petition For Writ of Certiorari in the section of their Brief that sets forth the reasons for denying the petition.

they are protected by appropriate judgment reduction, would discourage settlement and would be unfair to the Settling Defendants, who have paid to end the uncertainty and risk associated with this litigation.

Finally, the Private Securities Litigation Reform Act does not apply to the nineteen plaintiffs that joined the *Kayne* action after the effective date of the PSLRA. The plain language of the PSLRA governs its application, and that language clearly states that the Act applies only to *actions commenced* after December 22, 1995. As *Kayne*, which was commenced on January 23, 1995, is clearly an action, the PSLRA, by its own terms, does not apply to any plaintiffs in the action, regardless of the date that they joined.

Statement of the Case

A. Background of the Action

This action was filed on or about January 23, 1995, in the Central District of California, but was later transferred to the Eastern District of New York for coordinated and consolidated pre-trial proceedings with other MTC-related cases pending before Judge Gleeson. On October 14, 1998, Judge Gleeson approved the settlement of *In re MTC* and a related class action, *Ellis v. Leung*. Those settlements did not affect the action brought by the Kayne plaintiffs.

Plaintiffs' claims were based on alleged misrepresentations concerning MTC's purported telecommunications joint ventures and business interests in China. The defendants charged in the action included (a) MTC, (b) the former officers and directors of MTC, including its principals, whose alleged misconduct is the primary focus of the Complaint, (c) Diawa which underwrote

MTC's July 1993 public offering, and (d) BDO, which served as an auditor during the public offering.[2]

B. The Partial Settlement

In November of 2000, after seven and a half years of MTC litigation (now more than 10 years), BDO reached a settlement with Plaintiffs in the *Kayne* action. The agreement called for payment of $8 million by BDO in exchange for full settlement of any and all claims that Plaintiffs may have against BDO, in any forum, that are in any way related to the MTC litigation. In connection with the settlement, Plaintiffs and BDO agreed to execute mutual releases with respect to all MTC-related matters. Moreover, in order for BDO to effectuate its goal of being freed from the claims against it, the settlement was conditioned on entry of a bar order that would, *inter alia*, prohibit certain further claims against the Settling Defendants. Accordingly, in December of 2000, the Settling Defendants submitted applications to Judge Gleeson for such an order. On December 6, 2000, Judge Gleeson referred the matter to Chief Magistrate Judge Chrein.

C. Procedural History of the Bar Order

After receiving briefing from the parties and conducting an all-day hearing, Judge Chrein issued a thoughtful and well-considered Report and Recommendation relating to the partial settlements. (Joint Appendix ("JA") 46a-71a). In relevant part, Judge Chrein held that:

- The PSLRA did not apply to the 19 plaintiffs added to the action after the effective date of

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[2] Compared to its co-defendants, BDO had little involvement in the alleged misconduct—at most, BDO is alleged to have played a secondary role in connection with the purported joint ventures. This fact is not necessary, however, to BDO's argument here.

the Act because the Act did not apply to actions filed prior to the date of the enactment, (JA 44a-45a, 65a-66a); and

- The Non-Settling Defendants should be barred "from asserting any claims arising out of or reasonably flowing from the claims and allegations in the Kayne action," including any claims arising out of a comfort letter provided to those defendants by BDO. (JA 29a, 44a-45a, 69a).

On November 1, 2001, Judge Gleeson issued Orders adopting Judge Chrein's recommendations,[3] and dismissed with prejudice the Kayne plaintiffs' claims against BDO. (JA 27a-45a). On January 8, 2002, the District Court entered partial final judgment as to BDO. (Id.).

On appeal, the Second Circuit affirmed the District Court's decision regarding the PSLRA, (JA 25a-26a), and modified the settlement bar order regarding related claims, to make the language of the bar order clearly indicate that it barred indemnity, contribution, or other claims against BDO where the injury to the Non-Settling Defendants is the Non-Settling Defendant's liability to the Plaintiffs.[4] (JA 17a-21a). Moreover, the Second Cir-

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[3] Judge Gleeson made one modification which is not relevant here.

[4] The full text of the modified portion of the settlement order reads:

> Each of the Non-Settling Defendants is hereby permanently BARRED, ENJOINED and RESTRAINED from commencing, prosecuting, or asserting any claim *for indemnity of contribution* against BDO *(or any other claim against BDO where the injury to the Non-Settling Defendant is the Non-Settling Defendant's liability to the plaintiffs)*, arising out of or reasonably flowing from the claims or allegations in the *Kayne* action, whether aris-

cuit vacated and remanded the part of the District Court's order that related to the mutuality of the bar order for further consideration. (JA 21a-25a)

I

THE PSLRA BY ITS TERMS DOES NOT APPLY TO ANY ASPECT OF THIS CASE

In their Petition, the Non-Settling Defendants argue that the Second Circuit erred in concluding that the PSLRA's settlement provisions do not apply to nineteen of the twenty-six *Kayne* plaintiffs. (Petitioners' Brief ("Pet. Br.") 16-20). As discussed below, this contention is directly contradicted by the plain language of the PSLRA and by relevant case law.

A. The Plain Language of the PSLRA and FRCP 3 Preclude the Application of the PSLRA's Settlement Provisions to Any of the Plaintiffs in This Case

The Non-Settling Defendants contend that the Second Circuit should have ruled that the PSLRA's settlement provisions must be applied to the bar order because some of the *Kayne* plaintiffs joined the lawsuit by amendment after December 22, 1995. This reading of the PSLRA is

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ing under state, federal or foreign law as claims, cross-claims, counterclaims, or third-party claims, in the *Kayne* action, in this Court, in any federal or state court, or in any other court, arbitration proceeding, administrative agency, or other forum in the United States, Canada or elsewhere (collectively, the "Barred Claims"). These Barred Claims include, but are not limited to, any and all claims arising out of or reasonably flowing from "comfort letters" issued to Non-Settling Defendant Daiwa by BDO in connection with MTC, *to the extent that the injury to the Non-Settling Defendant under any such claim is its liability to the Kayne plaintiffs*. (Footnote omitted). (JA 20a-21a).

precluded by the plain language of the statute, which, as the Second Circuit noted, explicitly provides that it does "not affect or apply to any private action . . . commenced or pending on the date of the enactment of this Act" (*i.e.*, December 22, 1995). Pub. L. No. 104-67, 109 Stat. 737 (emphasis added); *see also Waters v. Int'l Precious Metals Corp.*, 190 F.3d 1291, 1297 (11th Cir. 1999) (observing that the PSLRA does "not apply to actions commenced before and pending upon its effective date"). Plaintiffs filed their original complaint on January 23, 1995, *eleven months prior to* the PSLRA's enactment date. The addition of new plaintiffs through amended complaints filed in 1996 and 1997 does not alter the fundamental fact that this action was "commenced" before the PSLRA's effective date. *See Edge Partners, L.P. v. Dockser*, 944 F. Supp. 438, 441 (D.Md. 1996) (holding that the PSLRA does *not* apply to securities fraud cases pending before December 22, 1995, *even if* plaintiffs amend their complaint thereafter); *Wallace v. Sys. & Computer Tech. Corp.*, No. Civ. A. 95-CV-6303, 1997 WL 602808, at *1 n.2 (E.D. Pa. Sept. 23, 1997) (rejecting argument that the PSLRA should apply to claims asserted in an amended complaint filed after December 22, 1995, when the original complaint was filed prior to the enactment date).[5]

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[5] The Non-Settling Defendants rather disingenuously argue that courts have applied the PSLRA not only to actions commenced after the enactment date, but to "claims asserted" after that date as well. (JA 16a-17a). The authorities they cite, however, simply do not support this interpretation. (Id.). *See Havenick v. Networth Express, Inc.*, 981 F. Supp. 480, 523 (E.D. Mich. 1997) (noting that the PSLRA "should apply to *all cases* filed after December 22, 1995") (emphasis added); *Hockey v. Medhekar*, No. C-96-0815 HMP, 1997 WL 203704, at *4 (N.D. Cal. Apr. 15, 1997) (holding that the PSLRA "applies to *all private securities actions* filed after December 22, 1995") (emphasis added).

The holdings of the Second Circuit, Judge Gleeson and Chief Magistrate Judge Chrein are supported by the language of Rule 3 of the Federal Rules of Civil Procedure, which provides that "[a] civil action is commenced by filing a complaint with the court." Fed. R. Civ. P. 3. *See McKowan Lowe & Co. v. Jasmine, Ltd.*, 976 F. Supp. 293 (D.N.J. 1997); *Sellers v. O'Connell*, 701 F.2d 575, 578 (6th Cir. 1983) (holding that, under Rule 3, an action was "commenced" on the date the original complaint was filed, despite the later filing of an amended complaint). *McKowan* is directly on point here. The *McKowan* plaintiffs filed their original complaint before the PSLRA's enactment date, then later amended their complaint to add several new defendants after the enactment of the Reform Act. The newly-added defendants argued that the PSLRA's mandatory discovery stay provision applied to them because they were added to the complaint after December 22, 1995. The *McKowan* court disagreed, holding that the plain language of Rule 3 precluded the partial application of the PSLRA: "the word 'commenced' in Section 108 of the Reform Act means the date the lawsuit was filed." *Id.* at 298. Like the Non-Settling Defendants here, the defendants in *McKowan* relied on cases raising the issue of whether the addition of new parties is timely under the applicable statute of limitations. *Id.* The court properly rejected the analogy. *Id.* In *McKowan*, as in this case, the "precise issue" before the court was "what Congress intended by 'commenced or pending on the date of enactment' " in Section 108 of the PSLRA. *McKowan*, 976 F. Supp. at 297. The *McKowan* court analyzed whether the PSLRA partially applied to an action filed prior to the enactment date where defendants were added after that date, and correctly concluded that it did not.[6]

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[6] The Non-Settling Defendants attempt to distinguish *McKowan* by downplaying its importance because it concerned a discovery

B. The Non-Settling Defendants Cite No Authority Whatsoever for the Proposition That the PSLRA Applies to the *Kayne* Plaintiffs Who Joined the Action After December 22, 1995

There is no authority in support of the proposition that, despite the plain language of the PSLRA and Fed. R. Civ. P. 3, the PSLRA should nevertheless apply to parties who join an action after the effective date, when the action was originally commenced before December 22, 1995. In the absence of any such authority, the Non-Settling Defendants rely on cases that discuss an entirely separate issue, namely, whether the addition of new parties relates back to the original complaint for statute of limitations purposes. These cases have no bearing on the issues before this Court.

Non-Settling defendants base their argument on *Adler v. Berg Harmon Associates*, 790 F. Supp. 1235 (S.D.N.Y. 1992), which involved a group of plaintiffs who, by joining a pending action, sought to assert claims that would otherwise have been time-barred by invoking section 27 of the Exchange Act, which revived actions "commenced on or before June 19, 1991" that had been dismissed as untimely under *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991). (Pet. Br. 17-18). Although the original complaint had been filed prior to June 19, 1991, the new plaintiffs did not join the action until after that date, and the *Adler* court rejected their claims. Contrary to the Non-Settling Defendants' characterization of the case, however, the language of

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motion is unavailing. (Pet Br. 19, fn. 11). They argue that the court's decision not to stay discovery is "unremarkable" because discovery would have proceeded in the case regardless of the court's ruling, that discovery could have been taken from the defendants as non-parties, and that, in any event, the court had discretion to lift the discovery stay. (Id.). These arguments badly miss the point. The Court decided that an action is commenced by filing a complaint.

section 27A played virtually no part in the court's decision. Rather, the court focused on the three part test under Fed. R. Civ. P. 15(c) for determining when new claims "relate back" to prior claims for statute of limitations purposes. The *Adler* court found that the "mistake" prong of Rule 15(c) was not satisfied, since there was no basis for concluding that the new plaintiffs would have been included in the original complaint but for a mistake of identity. The court did not address in even cursory fashion the question of when the action "commenced."

Moreover, as the Second Circuit noted, the Court in *Adler* refused to allow the reinstatement of claims made prior to the effective date of the statute. (JA 25a-26a, fn. 9). Here, in contrast, we are dealing with an *action* commenced before the enactment of the PSLRA. As the Second Circuit stated, "we find that the distinction between 'actions'—the phrase actually used in both statutes—and 'claims' is significant, and therefore disagree with Adler's reasoning." (Id.) Here, as the language of the PSLRA clearly refers to actions, and not claims, and the action at issue was filed before the effective date of the PSLRA, the PSLRA's provisions are not applicable.

C. Applying the PSLRA to Some Plaintiffs But Not Others Is Illogical

The Non-Settling Defendants' argument that the Second Circuit's holding on this issue has negative policy implications is a real stretch. First, as explained in the Plaintiffs' brief, a situation such as this is unlikely to ever recur, as few securities cases still remain in the court system that are not encompassed by the provisions of the PSLRA. Second, the Non-Settling Defendants' proposed result would unduly strain the courts and be impossible to administer, because plaintiffs in the same action and in the same class would be treated differently

depending on when they joined the class. In the words of the Second Circuit "we doubt that Congress intended that courts would apply different sets of substantive and procedural rules to groups of plaintiffs asserting identical claims in a single action, depending on when those plaintiffs were added to the complaint," (JA 262) and, as the District Court recognized, "applying the Act to only some claims would lead to confusion and inconsistency." (JA 662). Accordingly, public policy favors treating all plaintiffs in the same class the same in order to promote judicial economy and facilitate the prompt and fair administration of claims.

II

THE SCOPE OF THE BAR ORDER IS ENTIRELY APPROPRIATE UNDER APPLICABLE LAW

A. A Bar Order Narrower Than the One Entered in the Second Circuit Would Permit the Non-Settling Defendants to Bring Thinly-Disguised Claims for Contribution Against the Settling Parties

The purpose of a bar order is to encourage settlements by giving settling parties finality in the litigation. *Eichenholtz v. Brennan*, 52 F.3d 478, 486 (3d Cir. 1995).[7] This goal would be undermined if courts could only enter narrow bar orders that failed to shield settling defendants "against co-defendants' efforts to shift their

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[7] *See also In re Jiffy Lube Sec. Litig.*, 927 F.2d 155, 160 (4th Cir. 1991) ("The justification for imposing a bar to contribution . . . is that . . . the right to contribution removes the incentive to settle . . . "); *In re Nucorp Energy Sec. Litig.*, 661 F. Supp. 1403, 1408 (S.D. Cal. 1987) (observing that, without a bar order, "partial settlement of any federal securities case before trial is, as a practical matter, impossible").

losses through cross-claims for indemnity, contribution, and other causes related to the underlying litigation." *Id.* Here, the Non-Settling Defendants contend that the bar order entered below is overbroad because it precludes possible claims against BDO ostensibly arising out of BDO's comfort letter, for negligence or for malpractice. This argument fails for a variety of reasons.[8]

First, as noted by the Second Circuit, the Non-Settling Defendants are fully protected by the capped proportionate share rule, which "adequately compensates the non-settling defendants for their indemnity and contribution claims, as well as for any other claims where the harm to the non-settling defendants is based on their liability to the plaintiffs." (JA 18a). Under this rule the Non-Settling Defendants will get a reduction in judgments against them of the greater of the amount BDO paid in settlement or BDO's relative fault. With this rule in place, there is no equitable basis for the Non-Settling Defendants to pursue claims against BDO which effectively claim as damages the Non-Settling Defendants' liability to Plaintiffs, since any liability they may have to plaintiffs will be reduced by BDO's relative fault (indeed, it is highly possible that, due to the size of the Settlement Payments, the Non-Settling Defendants will ultimately pay plaintiffs far *less* than their proportionate share of any judgment).

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[8] The cases Relied on by Non-Settling Defendants are unpersuasive. *In re Cendant Corp Sec. Litig.*, 139 F. Supp. 2d 585 (D.N.J. 2001), is a post-PSLRA case. Indeed, the *Cendant* court distinguished *In re Oil and Gas*, *infra* at 12-13, as "a pre-PSLRA case in which the Court decided to approve a contribution bar which was broader than the current PSLRA language." *Id.*, 139 F.Supp. 2d at 596. Moreover, all three cases, *Cendant*, *In re Sunrise*, 793 F. Supp. 1306 (E.D. Pa. 1992), and *In re Cenco Inc. Litig.*, 642 F.Supp. 539 (N.D. Ill. 1986), are district court cases; the Non-Settling Defendants do not, and can not, point to a single circuit court decision that is contrary to the Second Circuit's holding in this case.

Second, the Non-Settling Defendants' purportedly independent claims arising from BDO's issuance of comfort letters in connection with MTC's July 1993 public offering (as well as their other hypothetical claims) are barred only to the extent that they seek the same damages as claims for contribution or indemnification. As the Second Circuit found, it is fair to bar such claims where the bar order is so limited because the Non-Settling Defendants can *only* be damaged to the extent they are liable to the plaintiffs in the underlying litigation, to the extent of their fault. (JA 19a). Federal courts recognize that "a rose by any other name is still a rose" and do not hesitate to bar non-settling defendants from asserting tort and contract claims that are, in effect, attempts to shift their liability to settling defendants. *South Carolina Nat'l Bank v. Stone*, 749 F. Supp. 1419, 1433 (D.S.C. 1990); *Bankers Trust Co. v. Rhoades*, No. 82 Civ. 5590 (WCC), 1992 WL 170677, at *2 (S.D.N.Y. July 2, 1992) (approving settlement bar order precluding claims "arising out of or in any way related to" the claims in the underlying litigation, and rejecting non-settling defendants' argument that the bar order was overbroad).

The combination of the broad judgment reduction provided for here with the limitation of the bar order as provided by the Second Circuit precludes the possibility of any unfairness here. Case law is supportive of this result. In *In re U.S. Oil & Gas Litig.*, 967 F.2d 489, 496 (11th Cir. 1992), the non-settling defendants argued that the settlement bar improperly barred their cross-claims for indemnity, breach of fiduciary duty, fraud and negligence against a settling defendant for its failure to disclose the fraudulent activities alleged in the complaint. *Id.* at 492. The Eleventh Circuit concluded that these claims were merely reworded contribution claims because the only injury to the non-settling defendants

was their potential liability to plaintiffs. *Id.* at 496. The court held that:

> The propriety of the settlement bar order should turn upon the interrelatedness of the claims that it precludes, not upon the labels which parties attach to those claims. If the cross-claims that the District Court seeks to extinguish through the entry of a bar order arise out of the same facts as those underlying the litigation, then the District Court may exercise its discretion to bar such claims in reaching a fair and equitable settlement.

Id. The *U.S. Oil & Gas* court recognized, as did the court below, that the important policy in favor of pretrial settlement of complex litigation is best served by bar orders that preclude non-settling defendants from bringing claims that seek the same relief as contribution claims. *Id.* at 493-94.

CONCLUSION

For all of the foregoing reasons, Respondents respectfully request that this Honorable Court deny the Petition.

Respectfully submitted,

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